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No. 96-676

Supreme Court, U.S.
FILED
JAN 2 1997
CLERK

In The

Supreme Court of the United States

October Term, 1996

SAMUEL M. DESARNO; ALICE DESARNO,

Petitioners,

vs.

COUNTY OF ALLEGHENY; PENN HILLS SCHOOL DISTRICT,

Respondents,

GARY GAERTNER,

Trustee.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Third Circuit

RESPONDENTS' BRIEF IN OPPOSITION

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QUESTION PRESENTED

Respondents, the County of Allegheny and the Penn Hills School District, claimed post-petition interest on oversecured real estate taxes at Pennsylvania statutory rates of 12% and 10% respectively in Petitioners', Samuel M. DeSarno and Alice DeSarno, Chapter 13 Bankruptcy. The Petitioners objected to the Respondents' claims proposing instead a 7% rate.

The Bankruptcy Court held that the "cost of funds" to the Respondents provided "present value" pursuant to 11 U.S.C. § 1325(a)(5)(B)(ii) but decided to apply Petitioners' 7% rate because it was proposed as "reasonable" by Petitioners and because it was higher than the rates judicially noticed by the court. The District Court affirmed. The Third Circuit reversed rejecting "cost of funds" and adopting a "market rate" approach. The question presented here is:

> Whether "present value" pursuant to 11 U.S.C. § 1325(a)(5)(B)(ii) is determined by a market rate of interest focusing on the Debtor's characteristics and ability to borrow rather than on the "cost of funds" to the creditor.

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Respondents request that this Court deny the Petition for Writ of Certiorari seeking review of an opinion of the Third Circuit Court of Appeals. The Third Circuit's opinion is reported at 89 F.3d 1123. (For the convenience of the Court all citations to that opinion will be to the opinion attached as Appendix 1-27 to the Petition.)

STATEMENT OF JURISDICTION

The Court must decline to exercise jurisdiction in this case pursuant to Supreme Court Rule 10(a) because contrary to Petitioners' assertions there are no United States Courts of Appeals which have entered decisions contrary to the Third Circuit's decision on substantially the same important question presented herein.

CORRECTION OF MISSTATEMENTS IN THE JURISDICTION SECTION OF PETITION

While the 12% interest rate claimed by the County of Allegheny is listed, the Petitioners fail to state that the interest rate claimed by the Penn Hills School District is 10%.

The Bankruptcy Court did not "set a rate based upon market conditions" as claimed by the Petitioners. (Petition at 2). The Bankruptcy Court adopted a "cost of funds" approach to determining "present value" pursuant to 11 U.S.C. § 1325(a)(5)(B)(ii). (Petition Appendix at 50). The "cost of funds" approach would have set an interest rate for oversecured municipal real estate tax claims solely at the rates which municipal creditors could borrow in the municipal bond market. The focus would have been entirely on the municipal creditor's characteristics and its ability to borrow at favorable rates based upon each municipality's bond rating and backed by the full faith and credit of each municipality's taxing power. The

Petitioners' characteristics were irrelevant to the Bankruptcy Court. The Bankruptcy Court adopted the Petitioners' proposed 7% rate solely because it was proposed by the Petitioners as "reasonable" and because it was higher than the bond rates to which the court took judicial notice. The "cost of funds" would have been the test in all other related Chapter 13 cases (and presumably Chapter 11 cases involving a determination of "present value" under the Bankruptcy Code) unless the Debtor proposed a higher rate as the Petitioners did here, which, after the Bankruptcy Court's decision, was unlikely. The same misstatement is set forth in the Petition.

Finally, the Petitioners misstate the Third Circuit's holding. The Third Circuit reversed the Bankruptcy and District Courts by rejecting "cost of funds" and holding that "present value" pursuant to 11 U.S.C. § 1325(a)(5)(B)(ii) is determined by a "market rate" of interest focusing on the debtor's ability to borrow. The court held that the "market rate" was best reflected in the Pennsylvania statutory rates proposed by the County of Allegheny and the Penn Hills School District. The same misstatement is set forth in the Petition.

In this case, the Petitioners merely disagree with the particular market rate selected by the Third Circuit. Because the Third Circuit rejected the "cost of funds" approach and held that a "market rate" applied, its decision is not in conflict with the Ninth Circuit's decision in *In Re: Camino Real Landscape Maintenance Contractor's, Inc.*, 118 F.2d 1503 (9th Cir. 1987), the Eighth Circuit's decision in *United States v. Neal Pharmacal Co.*, 789 F.2d 1283 (8th Cir. 1986) and the Eleventh Circuit's decision in *In Re: Southern States Motor Inns, Inc.*, 709 F.2d 647 (11th Cir. 1983), *cert. denied*, 465 U.S. 1022, 104 S. Ct. 1275, 79 L. Ed. 2d 680 (1984), which all specifically rejected "costs of funds" and adopted a "market rate" approach to determining "present value" under 11 U.S.C. § 1129(a)(9)(C).

STATEMENT OF CASE

Respondents, the County of Allegheny and the Penn Hills School District, filed claims for oversecured unpaid real estate taxes in the Chapter 13 Bankruptcy filed by the Petitioners, Samuel M. DeSarno and Alice DeSarno.

The County of Allegheny claimed interest post-petition at a market rate of 12% and the Penn Hills School District claimed post-petition interest at a market rate of 10%. The interest rates are subject to maximum limitations by Pennsylvania Statutes, but are adopted individually by the governing bodies of the County and School District. The Petitioners objected to the interest rates claimed by the County and School District claiming that a 7% rate was "reasonable".

The Bankruptcy Court, adopting a "cost of funds" approach held that municipal bond rates of 4.05% for the County and 4.30% for the School District provided "present value" pursuant to 11 U.S.C. § 1325(a)(5)(B)(ii) but adopted the 7% rate because of Petitioners' assertion that it was "reasonable" and because it was higher than the bond rates to which the court had taken judicial notice. (Petition Appendix at 50). The District Court affirmed. The Third Circuit reversed rejecting the "cost of funds" approach and adopted a "market rate" approach to determining "present value" pursuant to 11 U.S.C. § 1325(a)(5)(B)(ii). The market rates adopted by the Third Circuit for the County and the School District were the current rates adopted by the governing bodies of each Respondent and applicable to all delinquent taxes for all taxpayers.

The Third Circuit further held that the County was entitled to pre-petition interest at a rate of 12% and that the School District was entitled to pre-petition interest at a rate of 10% as provided by Pennsylvania law. The court also held that the

County and School District interest rates are modifiable pursuant to 11 U.S.C. § 1322(b)(2). These issues are not raised in the Petition before this Court.

The Third Circuit entered its judgment on July 30, 1996 and the Petition for Writ of Certiorari followed. The sole question presented to this Court concerns the narrow inquiry of whether "present value" pursuant to 11 U.S.C. § 1325(a)(5)(B)(ii) is satisfied by a market rate of interest which focuses on the debtor's characteristics and ability to borrow rather than the "cost of funds" to the creditor.

REASONS FOR DENYING THE WRIT

I.

THE THIRD CIRCUIT'S DECISION FOUND AT 89 F.3D 1123 IS CONSISTENT WITH THE NINTH CIRCUIT'S DECISION IN *IN RE: CAMINO REAL LANDSCAPE MAINTENANCE CONTRACTORS, INC.*, 118 F.2D 1503 (9TH CIR. 1987), THE EIGHTH CIRCUIT'S DECISION IN *UNITED STATES V. NEAL PHARMACAL CO.*, 789 F.2D 1283 (8TH CIR. 1986), THE ELEVENTH CIRCUIT'S DECISION IN *IN RE: SOUTHERN STATES MOTOR INNS, INC.*, 709 F.2D 647 (11TH CIR. 1983), *CERT. DENIED*, 465 U.S. 1022, 104 S. CT. 1275, 79 L. ED. 2D 680 (1984), AND THE THIRD CIRCUIT'S PRIOR DECISION IN *G.M.A.C. V. JONES*, 999 F.2D 63 (3RD CIR. 1993).

The Third Circuit's Decision below is consistent with the Ninth Circuit's Decision in *In Re: Camino Real Landscape Maintenance Contractors, Inc.*, 118 F.2d 1503 (9th Cir. 1987), the Eighth Circuit's Decision in *United States v. Neal Pharmacal Co.*, 789 F.2d 1283 (8th Cir. 1986), the Eleventh Circuit's Decision in *In Re: Southern States Motor Inns, Inc.*, 709 F.2d

647 (11th Cir. 1983), *cert. denied,* 465 U.S. 1022, 104 S. Ct. 1275, 79 L. Ed. 2d 680 (1984) and the Third Circuit's prior decision in *G.M.A.C. v. Jones,* 999 F.2d 63 (3rd Cir. 1993). As a result, there are no Circuit Court decisions which are in conflict concerning the same important matter presented herein. Therefore, certiorari is inappropriate here because this Court lacks jurisdiction in this case pursuant to Supreme Court Rule 10(a) and there is no other basis upon which this Court should grant certiorari.

There are some differences between this case and the cases cited above. For example, the Ninth Circuit in *Camino Real,* the Eighth Circuit in *Neal Pharmacal* and the Eleventh Circuit in *Southern States* all considered the applicable interest rate due post-petition to the United States as a creditor for unpaid priority tax claims pursuant to 11 U.S.C. § 1129(a)(9)(C). The Third Circuit in *Jones,* as here, considered the applicable rate of interest due post-petition on a secured claim pursuant to 11 U.S.C. § 1325(a)(5)(B)(ii) but the creditor in *Jones* was a commercial lender.

Despite the apparent differences between this case and the cases cited above, the "present value" language in the Bankruptcy Code provisions pertaining to both Chapter 11 and Chapter 13 proceedings is virtually identical and the courts have interpreted the language the same. (Petition at 6, note 1). Moreover, the Third Circuit in this case held that the principles of *Jones* nevertheless must be given effect to a governmental creditor as well. (Petition Appendix at 17).

The decision in this case as well as in the other Circuit Court decisions cited herein are consistent in holding that each creditor's interest rate is modifiable and that the "cost of funds" approach is inappropriate to determine "present value" under the Bankruptcy Code. "The debtor's characteristics determine

the interest rate. The creditor's characteristics are irrelevant. Hence, the fact that a particular debt arises from taxes due to the government does not affect the appropriate interest rate." *Camino Real,* at 1506. The Third Circuit in both *Jones* and in this case specifically found that the "cost of funds" approach fell short of the statutory objective of providing "present value" to the creditor. *Jones* at 67, 69; (Petition Appendix at 14).

Most importantly, all of the Circuit Courts cited above agree that the concept of "present value" has uniform application and meaning regardless of whether the allowed claim is priority or secured, is in a Chapter 11 or Chapter 13 case or is of a commercial or governmental creditor. "Present value is a market rate concept, determined by the use of an interest rate which fairly compensates the creditor for not receiving the full amount of its secured claim upon confirmation of the debtor's plan. There is wide disagreement, however, as to what constitutes an appropriate rate of interest in this context." (Petition Appendix at 12). *See also Neal Pharmacal* at 1285-1286.

Contrary to the Petitioners' assertion, the Third, Eighth, Ninth and Eleventh Circuits are in full agreement that a "market rate" of interest is appropriate to properly compensate creditors and provide them with the "present value" of their allowed claims paid in deferred cash payments over time pursuant to a confirmed repayment plan. *Camino Real* at 1508; *Neal Pharmacal* at 1289; *Southern States* at 652-653; *Jones* at 70; (Petition Appendix at 17-18).

The Petitioners claim that the Eighth, Ninth and Eleventh Circuits have taken a different approach than the Third Circuit in this case. (Petition at 10). The Petitioners' claim is erroneous. All of the above-cited Circuit Court decisions have specifically rejected the "cost of funds" approach and have adopted a "market rate" approach. The analysis in all cases is identical. The only

notable distinction between the decisions is that the courts have adopted different "market rates" of interest for determining "present value" under the Bankruptcy Code. This difference is expected in view of the differences between debtors and local market conditions from jurisdiction to jurisdiction.

For example, in *Southern States,* the court adopted the statutory rate requested by the government creditor but noted that the market rate was in fact in excess of the statutory rate. *Id.* at 653 In *Jones,* the Third Circuit determined the prevailing market rate to be that rate which the creditor would charge on the effective date of the plan for a loan of similar character, amount and duration that the creditor would offer to a person not in bankruptcy. *Id.* at 70. In *Neal Pharmacal,* the court remanded the case for a hearing to determine the prevailing market rate. *Id.* at 1289. *Camino Real* concerned three unrelated cases. The court reversed the decisions in two cases because the lower court had adopted a "cost of funds" approach which, as stated above, was rejected by the Ninth Circuit. *Id.* at 1508. The court remanded both cases for hearings to determine the appropriate market rate. *Id.* The court affirmed the interest rate adopted by the lower court in the third case but held, however, that the applicable market rate of interest was to be determined in the future on a case-by-case basis. *Id.*

In conclusion, all Circuit Courts agree that "present value" is achieved by providing the creditor with a "market rate" of interest. Petitioners' focus on the actual "market rate" chosen by the Third Circuit in this case (*i.e.*, the statutory rate) rather than on the Third Circuit's analysis and holding is misplaced.

CONCLUSION

For the foregoing reasons, the Writ of Certiorari should be denied.

Respectfully submitted,

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